



December 14, 2011

Office of the Secretary
Public Company Accounting Oversight Board
1666 K Street, NW
Washington, DC 20006-2803

Re: Request for Public Comment: Concept Release on Auditor Independence and Audit Firm Rotation, PCAOB Rulemaking Docket Matter No. 37

Dear Office of the Secretary:

On behalf of the board of directors of the National Association of Corporate Directors (“NACD”), we are pleased to comment on the Public Company Accounting Oversight Board’s (“PCAOB” or the “Board”) Rulemaking Docket Matter No. 037, “Concept Release on Auditor Independence and Audit Firm Rotation” (the “Concept Release”).

Founded in 1977, NACD’s mission is to advance exemplary board leadership, and the organization is the only national membership organization created for and by directors. NACD provides extensive board member training and education about leading practices for boards of directors. These educational programs include the responsibilities of audit committees over an issuer’s accounting practices and independent auditors (“auditors” or “audit firms”) under the Sarbanes Oxley Act of 2002 (“SOX” or the “Act”) and state law. In this regard, NACD encourages close interaction between auditors and the audit committee. NACD has a strong interest in the matters discussed in the Concept Release, including potential changes that would impact the role and responsibilities of audit committees under the Act.

Overview

NACD believes that auditor independence, reinforced through the rigorous application of professional objectivity and skepticism, provides the foundation for a quality audit. Further, NACD believes that the audit committee has, and should retain responsibility for demanding and overseeing that auditors perform at a high level of quality. While auditor rotation can be beneficial at times and should periodically be evaluated by the audit committee, we do not support that this rotation be made mandatory.

Given the aforementioned, NACD has not seen evidence that supports the proposition that mandatory audit firm rotation improves the auditor’s independence, objectivity, skepticism, or otherwise improves audit quality, and consequently, the quality of financial reporting. Rather, we believe that mandated audit firm rotation could potentially undermine the statutory responsibility and authority of audit committees to select the best auditor for their companies. It also would increase the cost to companies, and may decrease audit effectiveness.

Therefore, we believe that the PCAOB should drop consideration of mandatory audit firm rotation, and instead vigorously inspect for compliance with current auditing standards and independence rules and, where necessary, apply appropriate sanctions.

Audit Committees' Statutory Responsibilities

Prior to the implementation of SOX, the process for the selection and assessment of the independent auditor typically was controlled by management. The Act established qualifications for audit committee members and delegated to the audit committee specific responsibilities to represent and protect shareholders' interest in fair and accurate financial reporting. Audit committees now play an essential role in our corporate governance framework by assisting boards of directors in overseeing the quality and integrity of the company's financial statements. As the PCAOB knows, audit committees are specifically directed to appoint, compensate, and oversee the external auditor.

This elevation of the audit committee, supplemented by statutory and regulatory auditor independence requirements (including partner rotation), also greatly strengthened safeguards over auditor independence and mitigated risks that some believe are posed by the issuer pay model.

There has been substantial improvement in audit committee oversight of the financial reporting and auditing processes over the past decade. Nevertheless, we recognize that there is room for further improvement. Accordingly, NACD is working to promote a consistent high level of audit committee performance through its director training courses and development of leading and "next" practices, as well as tools designed to support the audit committee's oversight of financial reporting within their companies. For example, NACD has convened numerous Blue Ribbon Commissions that have issued reports on a variety of topics, including executive compensation, risk oversight, and board leadership. One of the latest results of these efforts, *The Report of the NACD Blue Ribbon Commission on the Audit Committee - 2010* ("*BRC Report on the Audit Committee*"), offers ten principles to guide audit committees.

NACD believes that mandatory audit firm rotation could jeopardize the statutory responsibility and authority of audit committees to select the best auditor for a company and oversee its work. The authority of the board and its committees is at the heart of our corporate governance framework, and challenging that authority could result in an undue weakening of the oversight and guidance directors provide for U.S. companies.

Consequences of Mandatory Audit Firm Rotation

The PCAOB seems to be implying that audit committees, acting on behalf of all shareholders, are not able to determine the best auditor for their companies on an ongoing basis. To that end, the PCAOB seems willing to interfere with private contracts between audit committees and auditors. This interference may constrain the ability of audit committees to select the audit firms that are best able to meet the particular accounting and auditing challenges presented.

Mandatory audit firm rotation may also engender prohibitive disruption and cost for companies without offering any compelling benefits. For example, the complexities of multinational corporations and differing regulatory regimes require companies to use auditors with particular expertise regarding country accounting nuances and laws. Replacing auditors who understand the company's financial reporting risks and the jurisdictional requirements—and who the audit committee believes is performing well—without having a sound business case would be unnecessarily disruptive to the

company, its board, and its audit committee, and in some cases, would be prohibitively expensive. It also would create cross-border accounting and auditing risk—again, without any compelling benefit.

Another example is the impact mandatory firm rotation would have when it occurs at a time when a company is going through a significant event such as a corporate financing, merger or acquisition, or change in management. Changing auditors at such a time would greatly expand the cost of the transaction or transition, and potentially affect the ability of the company to execute a transaction. Moreover, an audit firm rotating in would have to meet independence requirements, which would cause companies to have to change providers of its non-audit services. The time and resources required for management and audit committees to manage all of these transitions would be significant. Moreover, the additional work required for a new firm to get up to speed would add cost and possibly delay to the audit.

Finally, we are concerned that that mandatory audit firm rotation would increase accounting and auditing risks during the first years of an auditor's tenure. Studies have shown that audit quality is enhanced when the auditor develops an understanding of a company's business and applies that knowledge when performing audit procedures.

Improving the Audit Committee's Oversight of the Auditor

NACD and its constituents continue to explore ways to improve the performance of audit committees and their oversight of the external auditor. A number of leading practices are contained in NACD's *BRC Report on the Audit Committee*. Below, we share some additional ideas that would further the goals of strengthening audit committees and enhancing audit quality, without the unintended consequences associated with mandatory audit firm rotation.

Communications with Shareholders

NACD encourages expanding audit committee reporting beyond the proxy requirements—for example, to provide a more robust description of the audit committee's activities during the year. Providing greater transparency into audit committee activities and, in particular, its role in overseeing the company's financial reporting, as well as its selection and evaluation of the auditors, would help shareholders evaluate the audit committee's performance.

One approach might be to enhance the audit committee report in the company's proxy or, alternatively, the company's website. This would provide a venue for describing the audit committee's criteria for evaluating the auditor's independence and performance—including the auditor's objectivity and professional skepticism—as well as its policies regarding the auditor's provision of non-audit services. Such a report also might describe at a high level how the audit committee oversees the accounting and financial reporting processes of the company, including discussions with the auditor about the quality of the company's accounting. Enhanced reporting would provide greater transparency into the quality of the audit committee's performance, the company's financial reporting, and the caliber of the external auditor.

Appointment, Oversight, and Evaluation of the Independent Auditor

As noted earlier, NACD supports continuous improvement in the caliber and performance of audit committees. Accordingly, NACD is working to promote a consistent, high level of audit committee performance through its board member training courses and development of leading practices and tools designed to support the audit committee's oversight of financial reporting within their companies. In

addition to the leading practices summarized in NACD's *BRC Report on the Audit Committee*, some leading and "next" practices audit committees could employ include:

- Evaluating the audit plan in a more robust fashion, including the details of the auditor's risk assessment, the procedures planned to address those risks, and milestones for completion. This includes following up on those milestones and maintaining an "open door" for the auditors to discuss the use of particular accounting policies and operating practices that are necessary to assure the audit will meet the audit committee's expectations. The consideration of audit risk, including assuring that the audit team has the right experience and resources available to execute the plan, is vital.
- Improving audit quality through the annual evaluation of the audit firm. Annual evaluations should be the primary consideration in the reappointment of the audit firm. Therefore, the committee's assessment of an audit firm should consider, among other matters:
 - Input from the management team about the firm's understanding of the business and its helpfulness in the early identification of important issues.
 - How the firm supported the audit committee's work.
 - How the firm supported the chair of the audit committee.
 - How candid and forthright the firm was in its work with both the committee and the management
 - Overall, how effective, efficient, and timely was the resolution of any technical issues.
- Analyzing and discussing the results of the annual evaluation and being responsible for providing feedback to the audit firm. This includes monitoring the firm's response to any areas needing improvement.
- Taking the lead role in interviewing and selecting the lead engagement partner. This enables the audit committee to assess the qualifications, including the independence, objectivity, and professional skepticism of the candidates for this role as well as each candidate's ability to communicate effectively with the audit committee and his/her fit with the company's business and complexity.
- Monitoring the auditor's performance. Inspection findings pertaining to a company's audit are of critical importance to the audit committee as they reflect the competency of the auditor and can reflect on company management. NACD is working with the Center for Audit Quality to develop tools for improving awareness and framing discussions with the auditor on inspection results and quality control within the audit firm, more generally. NACD would be happy to share our expertise in conversing with board members, and to work with the PCAOB in developing tools to educate audit committees about the PCAOB's inspection program and inspection reports.

NACD supports the PCAOB's efforts to enhance audit quality. However, we do not believe that mandatory auditor rotation is the way to do so. Before further consideration of such a drastic and disruptive change to the current corporate governance framework is initiated, a strong case must be made that auditor tenure has a significant bearing on audit quality. We do not see auditor independence as the issue. Rather, we believe the focus of the PCAOB should be on the exercise of professional

skepticism and objectivity by auditors and all members of the financial reporting supply chain in discharging their respective responsibilities. Moreover, we believe that the PCAOB, with its ten years of deep knowledge about its registrant auditing firms, should have good information on ways to improve those traits in particular firms and the public accounting profession.

NACD appreciates the opportunity to comment on this Concept Release and would be pleased to respond to any questions regarding the views expressed in this letter.

Sincerely,

A handwritten signature in black ink that reads "Barbara Hackman Franklin". The signature is written in a cursive style with a long horizontal line extending to the right.

Barbara Hackman Franklin
Chairman
NACD

A handwritten signature in black ink that reads "Kenneth Daly". The signature is written in a cursive style with a large loop at the end.

Kenneth Daly
President and CEO
NACD